

Table 9					
	Number of CLECs at wire center				
	0	1	2	>3 (11)	BST Average
Probability	0	0.0323	0.0636	0.3031	0.1579

	Number of CLECs at wire center				
	0	1	2	>3 (11)	BST Average
Probability	0	0.0020	0.0040	0.0218	0.0123

As Table 10 demonstrates, when the more realistic and more appropriate measure of CLEC on-net facilities is utilized — i.e., CLEC-served buildings as a percentage of *all* commercial buildings served by the wire center — the “likelihood that [competitive] Special-Access type facilities will be available” to serve any potential CLEC customer is only about 1.23%, a far cry from the patently absurd 75.9% figure posited by EMG.

28. Even this corrected “analysis” does not provide a fully accurate assessment, in that it still assumes a random distribution of on-net buildings for each CLEC and further assumes that the AT&T-average applies in each and every wire center and for each and every CLEC collo-

but as long as the misallocation bias is systematic over time, the trends revealed through an examination of multiple years' results will still provide an accurate picture of ongoing market dynamics. Although there is inevitably some subjectivity involved in allocating costs that cannot be directly assigned, the methodology itself, and hence the resulting allocations, do not fluctuate significantly from year to year. Thus, if competition for special access services were actually constraining prices as the RBOCs contend, the ROR for special access would tend to decrease over time. But in fact it is actually *increasing*, suggesting not only that price-constraining competition is not present, but that the extent of ongoing RBOC market power with respect to these services is growing.

76. Finally, suddenly *relying* upon ARMIS data, Kahn and Taylor have contended that the average revenue per line for special access has actually been decreasing "by more than 1% per year" during the 1996-2001 period. My own review of the data suggests errors in the Kahn/Taylor analysis. Based upon replicable ARMIS data, the average revenue per line, decreased by only two-tenths of one percent over the entire period (a reduction in average annual revenue per line of only \$0.33). As I will discuss in more detail below, use of an average annual revenue per line calculated using DS-O equivalents is seriously flawed, but even accepting the flawed Kahn/Taylor evidence, the data proves, rather than disproves AT&T's allegations. At page 16 of the Kahn/Taylor declaration, a figure appears entitled "RROC Special Access Revenue per Special Access Line". Even a cursory review of that Figure reveals declining revenue per line amounts occurred during the period 1997-2000 — when the special access rates were still generally subject to price caps and the x-factor-driven annual reductions associated therewith — and that there has been a total reversal of that trend (recouping virtually all of the reductions during the prior four years) in the RBOCs' revenues for 2001 — the first full year during which any of the RBOCs had pricing flexibility for Special Access Services.¹²⁵

125. BellSouth, the first RBOC to apply for and be granted pricing flexibility, approved
(continued...)

1 anything from EMG's results — even if otherwise accurate on an aggregate, market-wide basis
2 — as to the likelihood of a CLEC's facilities presence in buildings where only minimal dedicated
3 special access capacity is required.

4
5 Verizon's ***Competition for Special Access Services*** report provides a false and entirely
6 misleading assessment of the actual state of competition for special access services
7

8 30. Verizon has also provided a grossly exaggerated picture of facilities-based special
9 access competition through its "Competition for Special Access Services" report." Several of
10 the report's claims raise theoretical rather than factual matters addressing competition and are
11 being addressed elsewhere in AT&T's Reply Comments." For example, AT&T's comments
12 point out that Verizon's comparisons of "voice grade equivalent" lines reflect very high-capacity
13 links of various types rather than the scope of the availability of competitive alternatives; that
14 Verizon's listings of cities with CLEC "networks" indicate very little or nothing about the
15 presence of CLEC "on net" buildings, if any, in a served MSA; and that Verizon's claims
16 regarding CLEC resale of ILEC special access services simply confirm that CLEC facilities that
17 compete with ILEC's facilities are very limited in scope and, with respect to Verizon's comparison
18 of special access resale to UNE resale, that the UNE use restrictions are unduly constraining.*
19

25. (...continued)
up to 77%. In addition, Ameritech's filing identifies \$122.9-million as revenues for DS-3
circuits. There is no separate break-out for OCn, but even if half of the anticipated DS-3
revenues were from associated with OCn-level circuits, the total percentage of revenues from
circuits at or below DS-3 levels would be 87%.

26. See *In the Matter of AT&T Petition for Rulemaking to Reform Regulation of Incumbent
Local Exchange Carrier Rates for Special Access Services*, KM 10593, *Verizon Report on
Competition for Special Access Services*, filed Dec. 2, 2002 ("Verizon Report").

27. See AT&T Reply Comments. *supra* at 10-19.

28. See Verizon Report, at 12-13, 21-23, 26

1 71. *Packet switching costs not in special access.* Qwest claims that packet switching costs
2 incurred to provide certain special access services (Frame Relay, ATM) are assigned to the
3 general switching category, and not to special access.¹²³ However, Qwest does not quantify the
4 amount of costs that it claims are misallocated. Moreover, Qwest neither claims nor makes any
5 effort to establish in its comments that revenues associated with the switching functions used to
6 provide frame relay and ATM services are not also being reflected in one of the several different
7 switching *revenue* accounts identified in Part 32. Put simply, Qwest has failed to demonstrate
8 any mismatch, inasmuch as it has focused solely upon the assignment of *costs* and not addressed
9 the treatment of the corresponding *revenues*. The Commission thus has no basis to evaluate the
10 validity or importance of criticisms such as this one, when the RBOCs, which have by far the
11 best access to the underlying information, present only their contentions but with no facts or
12 specifics to back them up.

13
14 72. *Secondary and tertiary expenses:* Finally, Qwest complains that because carriers are
15 required to assign secondary and tertiary expenses in proportion to the primary investments
16 assigned to a category, any potential underallocation of primary investments to special access
17 would be exacerbated. However, this is merely another theoretical argument. As discussed
18 above, the RBOCs have simply not established that primary investments are not being properly
19 assigned to the special access category. Moreover, the magnitude of these secondary and tertiary
20 expenses is simply not large enough to offset to any significant extent the RBOCs' substantial
21 overearning for the special access services.

22
23 73. It is also worth recalling that **ARMIS** costs are *embedded* costs, which are generally
24 higher than forward-looking incremental costs (i.e., TELRIC). If forward-looking costs of

123. Qwest Comment, at 12

1 that web site has discontinued its locator services and contains no postings for the sale of unde-
2 ployed fiber.³² And throughout its “analysis,” Verizon relies upon sources published by the New
3 Paradigm Resources Group, which takes a naively uncritical view of the CLECs’ condition as it
4 discharges its role as cheerleader for this beleaguered industry sector. New Paradigm twists
5 financial reality by proposing that bankruptcy is somehow just a normal business condition that,
6 fortuitously, has the advantage of reducing interest expenses.”

7
8 34. In fact, bankruptcy is a severe impediment to competition and one that infuses the
9 sector, limiting current service provision and having even more significant consequences for
10 ongoing competition. As AT&T has shown and certainly not surprisingly, major IXC customers
11 cannot contract confidently with special access providers in bankruptcy — in large part because
12 their end user customers quite sensibly will not tolerate such arrangements.³⁴ Bankruptcy is
13 particularly debilitating in a capital intensive industry, where credit-worthiness is, by definition,
14 of paramount importance in raising the funds necessary to support continued operations (for cash
15 flow-negative suppliers), to enable capital expenditures necessary to continue to provide service
16 to current customers, and to undertake network expansion.

17
18 35. The roll call of bankrupt suppliers of special access services continues and includes
19 some of the most significant providers. In the first nine months of 2002, newly bankrupt
20 providers include³⁵:

32. See www.fiberloops.com/Fiberloops/posts.htm.

33. New Paradigm Resources Group, Inc., *CLEC Report 2003*, Chapter 2 at 2 (17th ed. 2003) (“Chapter 11 Bankruptcy: A Hindrance or A Benefit?”) (“CLEC Report 17th ed.”).

34. See *In the Matter of AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, RM No. 10593, Declaration of Kenneth Thomas on Behalf of AT&T at para. 9-10, Filed October 15, 2002 (“Thomas Decl.”).

35. See CLEC Report 17th ed., at Ch. 2, Table 1.

68. Using this alternative analysis, the special access rate of return drops by slightly less than 6% for 2001 (and less than 3% for 2000). Nevertheless, the RBOCs still enjoyed rates of return on special access services above 30% which, *by any conventional standard* — and especially during the current economic downturn — is indicative of supracompetitive earnings arising through the RBOCs' exercise of market power. While BellSouth, Qwest and Kahn/Taylor may attempt to muddy the water by raising the "DSL issue," even the "worst case scenario" — where all DSL revenues are included and all DSL costs are excluded — cannot "explain" the persistently excessive rates of return that prevail with respect to special access services.¹¹⁸

69. Significantly, while the RBOCs rny *claim* that DSL investments and expenses are not being allocated to special access, recent investment trends tend to suggest otherwise. As the following table confirms, between 1996 and 2001, RBOC (including GTE) special access investments grew from \$5.7-billion to more than \$12.2-billion. By comparison, most other categories of RBOC interstate investment remained largely unchanged over the corresponding time frame, and intrastate investments actually *decreased* by nearly \$10-billion. Given the rapid growth of DSL and the high capital costs that have been ascribed to its deployment, it is difficult to imagine any other explanation for the more than doubling of special access investment while all other categories remained essentially the same or even decreased, if DSL is *not* included within

118. In several other proceedings before the Commission, the RBOCs have sought to portray the market for DSL as so highly competitive as to justify regulatory forbearance, if not outright deregulation. See, e.g., *SBC Petition for Expedited Ruling that it is Non-Dominant in its Provision of Advanced Services and for Forbearance from Dominant Carrier Regulation of Those Services*, CC Docket No. 01-337, SBC Petition, October 3, 2001. Their experts have suggested that the highly competitive nature of the "high-speed Internet access market," wherein DSL competes with cable modem services, has placed the RBOCs in a non-dominant position and, in fact, has not even permitted them to recover the costs of providing ADSL services, which are put as high as \$86 per month. See, Declaration of Robert W. Crandall and J. Gregory Sidak, filed as Attachment A in the above petition, at 51. It would seem that, in the various "broadband" proceedings, DSL is actually being provided at a loss, whereas in the instant docket DSL is portrayed as being so enormously profitable that it is pushing up special access returns to supracompetitive levels. At the very least, these DSL stories *dujour* demand careful scrutiny.

Table 11			
Major Competitive Providers of Special Access			
Company	Special Access Revenue (2001 in millions)	Company	Special Access Revenue (2001 in millions)
AT&T	\$2,880	McLeod USA	
World Com	\$2,207	KMC Telecom	
Qwest	\$380	General Comm.. Inc.	
Time Warner	\$384	Adelphia Bus. Solutions	
XO Communications	\$378	BTI Telecom	
IDT/WinStar	\$190	NTS Communications	
ICG Communications	\$165	Cablevision Lightpath	\$28
ITC^DeltaCom	\$96	Cox Communications	

37. Apart from [he implications of bankruptcies, the publicly released information regarding the networks, services and revenues of many of the largest special access providers should be regarded as overstated through undue optimism (if not outright misrepresentation). Major special access providers that are expected to restate their financial information and related service claims include WorldCom, Qwest, and Adelphia Business. The example of Winstar is instructive in assessing Verizon's current claims. Of the more than \$900-million in CLEC revenue that Winstar had claimed when it was acquired by IDT, IDT discovered that nearly \$750-million reflected fiber swaps that were irrelevant to CLEC competition.³⁸ Despite its earlier uncritical analyses, New Paradigm now estimates that \$120-million of the asserted Winstar revenue was derived from resale of ILEC services, indicating that only slightly less than 9% — or about \$80-million — of Winstar's claimed \$900-million in revenue resulted from services provided over its own facilities.³⁹ This example accords with AT&T's conclusion that

38. See New Paradigm Resources Group, Inc., *CLEC Report 2002*, Carrier Profile of Winstar Communications at 2 (16th ed. 2002) ("CLEC Report 16th ed.").

39. *Id.*

1 of this estimate.¹¹⁷ Inasmuch as Kahn/Taylor's DSL revenue figure of \$410-million is
2 unsupported and refers only to 2001 revenues, I have prepared an additional estimate of special
3 access rates of return without DSL revenues, using verifiable sources. Table 12 below contains
1 rate of return calculations employing alternate estimated **DSL** revenues.

117. BellSouth Comments, at fn. 6

CLECs' special access revenue continues on a robust growth trajectory,⁴⁴ the New Paradigm research group now anticipates flat revenues for the sector — even with the current customer base experiencing steady growth in use of services. New Paradigm as recently as 2002 had projected that CLEC dedicated access and private line revenues would increase by 61% from 2001 to 2005.⁴⁵ More recently, New Paradigm has lowered these predictions and now estimates only 11.6% total growth from 2002 to 2006 — less than a 2.8% increase annually.⁴⁶

40. Second, Verizon's overstated claims collapse when it attempts to use FCC-sourced information. Verizon asserts that the CLECs have revenue share of approximately 30% based upon 2000 figures of \$4.2-billion of FCC-reported revenue, supplemented by self-supply of \$1.3-billion in 2001, compared to ILEC special access revenues of \$13-billion in 2000.⁴⁷ This analysis contains three flaws: (1) it excludes non-RBOC ILEC revenues (amounting to \$1.1-billion, or 8.1%, of ILEC local private line and special access revenues);⁴⁸ (2) it compares the 2001 self-supply revenues of competitive carriers with the 2000 **RBOC** numbers, deflating the RBOC number by \$5-billion on Verizon's own calculation;⁴⁹ and (3) it includes revenues in the relatively more contested and irrelevant long distance private line services market (\$985-million, or 23%, of CLEC revenues but only 7.5% of ILEC revenues).⁵⁰ Even using Verizon's sources

44. See Verizon Report at 27. Verizon also makes projections for the value of self-supply access for AT&T and WorldCom based upon the increase from 1998 to 1999. *Id.* at 28.

45. See CLFC Report 16th ed. at Ch. 3, Table 13.

46. See CLEC Report 17th ed. at Ch. 3, Table 9.

47. Verizon Report, at 28.

48. See FCC, Industry Analysis Div., *Telecommunications Industry Revenue 2000*, at 13 & 17 (Jan. 2002).

49. Verizon Report, at 28.

50. FCC, Industry Analysis Div., *Telecommunications Industry Revenue 2000*, at 13-14, 17-

1 rates of return as calculated by A I & T, and/or (d) offset by other allocation adjustments that cut
2 in the opposite direction.

3
4 66. *DSL costs and revenues.* Kahn/Taylor, BellSouth and Qwest note that most carriers
5 include DSL revenues in ARMIS-reported special access revenues, while special access accounts
6 are typically assigned only a fraction of the costs.¹¹⁴ Qwest indicates that:

7
8 the rules assign revenues associated with Digital Subscriber Line ("DSL")
9 services and interstate packet switching services to the special access element,
10 but assign a significant portion of the associated interstate costs to other
11 elements. Taken together, these issues significantly inflate the rate-of-return
12 numbers upon which AT&T places so much reliance.¹¹⁵
13

14 The actual impact, however, of this DSL revenue upon special access rates of return is
15 demonstrably minor. First, SBC *does not* include DSL revenues in its special access service
16 category.¹¹⁶ As for the other RBOCs, the Table below excludes DSL revenues based upon
17 Kahn/Taylor estimates, and recalculates special access rates of return with DSL revenues
18 removed.

114. Kahn/Taylor Decl., at 14-15; BellSouth Comments at 6; Qwest Comments at 4-5.

115. Qwest Comments, at 4.

116. Kahn/Taylor Decl., at fn. 28.

- 1 • WorldCom's 2001 special access revenue is presented as \$2.207-billion, but New
2 Paradigm now estimates that figure to be \$1.62-billion.⁵³ Even that reduced figure
3 appears to include WorldCom's international revenues.
4
- 5 • The Qwest figure of \$480-million apparently includes special access revenues derived
6 from provision of certain special access services within Qwest's incumbent region, as
7 well as international revenues.⁵⁴ The Qwest figures, in any event, predate Qwest's
8 massive downward revisions of revenues and, given Qwest's ownership structure,
9 would be questionable evidence of true competition between ILECs and CLECs.
10
- 11 • IDT/Winstar's special access revenues are presented as \$1 YO-million. New Paradigm
12 estimates that the company's special access revenues for 2002 were only \$24-million.⁵⁵
13
- 14 • ICG Communications' special access revenues are presented as \$165-million. New
15 Paradigm estimates that the company's special access revenues for 2002 were \$133-
16 million."
17

53. *Id.*, WorldCom carrier profile at 1, 5 (estimating that dedicated access transport accounted for 14 % of total revenues, which were \$1 1.6 billion).

54. *Id.*, Qwest carrier profile at 3 (describing Qwest's strategy to market services in the 14-state region previously served by U.S. West, with whom Qwest merged in 2000).

55. *Id.*, Winstar carrier profile at 1, 5 (estimating that dedicated access transport accounted for 20% of IDT/Winstar's total revenues, which were \$120 million).

56. *Id.*, ICG Communications carrier profile at 1, 5 (estimating that dedicated access transport accounted for 29% of total revenues, which were \$460,000).

3. ARMIS RESULTS PROVIDE A VALID DEMONSTRATION OF SPECIAL ACCESS
RATES OF RETURN THAT ARE EXCESSIVE BY ANY REASONABLE STANDARD

ARMIS data provides a *conservative* estimate of RBOC rates of return on Special Access Services, and confirms that these are clearly excessive by any reasonable standard.

62. Each of the RBOCs has taken exception to AT&T's use of ARMIS data to demonstrate that the RBOCs have for several years been earning excessive rates of return on special access services, and that these rates of return are increasing at the same time as the RBOCs obtain greater and greater pricing flexibility. The RBOCs' general and specific criticisms of such ARMIS-based conclusions are without merit.

63. ARMIS is simply not the regulatory white elephant that the RBOCs make it out to be. Although ARMIS has been scaled back since the onset of price cap regulation, the Commission has repeatedly resisted eliminating the core reporting requirements of the ARMIS system. The Wireline Competition Bureau's Industry Analysis Division states in "ARMIS Frequently Asked Questions" that the data is used to support the Commission's analysis of broad policy issues, including the "Financial Conditions of the Industry (How Carriers are Doing and How Our Regulatory Programs are Working)" and "Consolidations and Mergers (Measure Changes in Productivity, Profitability, Service Quality)," as well as numerous areas of focused study, including "Rate development," "Depreciation," "Cost," "Financial Analyses," "Rate of Return," "Trend Analysis," and "Identification of Audit Topic/Subjects."¹¹⁰

64. Moreover, even as ARMIS has been revised, the FCC has made it clear that the reporting requirements support the Commission's ability to monitor the effectiveness of its regulatory policies. The Commission has repeatedly signaled that price regulation does not

¹¹⁰ ARMIS FAQ, embedded file at <http://www.fcc.gov/wcblarmis/> (accessed 1/22/03)

1 purposes of judging facilities-based competition — are much lower than the total revenues they
2 report, because of the high portion of special access they provide over resold **RBOC** lines. Fifty-
3 six percent of 2001 RBOC special access revenues (estimated by Verizon to total \$1 X-billion)
4 amounts to \$10-billion — nearly all of CLEC special access revenues based upon even the most
5 aggressive assessments used by Verizon and the New Paradigm Resources Group. Deductions
6 from the \$10-billion figure due to resale for upstream services would be at least in part offset by
7 the margin that CLECs would need to add to the ILEC special access services that they resell.
8 Whatever reasonable assumptions are used, the overwhelming majority of CLEC special access
9 revenues are attributable to resold ILEC services rather than to facilities-based special access
10 services. And that much smaller figure attributed to "on net" revenues is dwarfed by the \$28-
11 billion that Verizon estimates for the entire special access market.

12
13 **Verizon Fails to Show that CLECs Can Economically Connect to More Than a Small**
14 **Percentage of Buildings.**
15

16 43. As I have noted above, CLEC facilities reach only a minute fraction of all commercial
17 buildings in the US. Of greatest importance to the touchstone competition inquiry, the
18 "availability of competitive alternatives," only a small percentage of buildings are or can be
19 connected economically through "on-net" services provided exclusively over non-ILEC
20 facilities." Consequently, and as AT&T has explained before, competitive providers of special
21 access services can economically reach only a small fraction of the commercial buildings that
22 hold potential customers."

60. See *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-339, Declaration of Michael E. Leshner and Robert J. Frontera on Behalf of AT&T Corp., at paras. 41-42.

61. See Thomas Decl., at para. 12.

1 evidence of competition in these markets shows that the ILECs are not engaging in price
2 squeezes and related anti-competitive power available to them through market power in special
3 access services. The arguments prove nothing regarding competition in the market for special
4 access services, nor do they rebut or present any inconsistency with evidence that has been
5 presented to the Commission that the ILECs have in fact engaged in such anti-competitive
6 activities.

7
8 59. Even if Verizon's competition figures in downstream markets could be accepted as true,
9 the evidence has no bearing on any conclusion that might be drawn about special access compe-
10 tition. ILECs' having the opportunity to gain market share in these markets is precisely what
11 provides ILECs with the incentive, combined with the ability provided by their dominance over
12 special access facilities, to engage in anti-competitive conduct. Showing the robustness of com-
13 petition in those markets only indicates that, due to resulting competitive margins, non-ILEC
14 competitors will be vulnerable over time to anti-competitive actions. And, of course, the
15 Verizon materials show that the ILECs have been gaining market share in the long distance and
16 ATM/Frame Relay markets, just as would be expected if they were engaging in anti-competitive
17 price squeezes and non-price discrimination against downstream competitors.¹⁰⁴

18
19 60. Indeed, Verizon confirms that, for two of the largest markets, RBOCs' market share
20 increases have been limited only by regulations that are disappearing monthly, and Verizon
21 concedes that RBOCs in fact dominate the third market, for local services provided to large
22 businesses. Verizon claims that RBOCs have not yet established a significant market share in
23 enterprise long distance and then candidly notes that "[t]he Bell Companies have only recently
24 begun providing long distance service to business customers in some states."¹⁰⁵ Verizon

104. See Verizon Report, at 29-30

105. *Id.*, at 29.

1 number of buildings served arc Knology Broadband, with 149,950 buildings served,⁶⁷ and XO
2 Communications, with 84,370 buildings served.⁶⁸ Both Knology and XO have in recent months
3 entered bankruptcy." New Paradigm now indicates that Knology has zero special access
4 revenues, and in fact the "buildings" served apparently reflect residential cable TV and related
5 retail services.⁷⁰ Despite its earlier estimates, New Paradigm now indicates that reliable
6 information regarding XO's buildings connected is not available.⁷¹

7
8
9 47. Verizon also points to the concentration of special access customers, assessed by iraffic
10 and revenue, in relatively few buildings." As a general proposition, and as compared to the total
11 special access market, there are relatively few buildings where customers **and** demand are highly
12 concentrated. Indeed, this is precisely the reason that the MSA-based exemption does not reflect
13 competition because competitive alternatives remain unavailable in a large portion of the partic-
14 ular Phase II markets. Verizon's claims regarding the importance of just four **MSAs** (New York,
15 San Francisco, Washington D.C., and Los Angeles) emphasize the difficulties of providing
16 broadly available competitive alternative facilities and services in the many other **MSAs** where
17 Phase II relief has been granted. Even so, the estimates of concentration that Verizon cites
18 appear to be considerably exaggerated because they are limited to data **iraffic**, which itself
19 represents only a relatively small portion of the market.

67. See CLEC Report 16th ed., Knology carrier profile at 1.

68. *Id.*, XO carrier profile, at 1.

69. See CLEC Report 17th ed., Chapter 2 at Table 1

70. *Id.*, Knology carrier profile, at 1-5.

71. *Id.*, XO carrier profile, at 1.

72. See Verizon Report, at 13-14

1 are facing their own financial and operational problems.”” The result is that ... industry revenues
2 are expected to continue their recent decline for at least for the next two years.⁹⁷ And that will
3 inevitably lead to more business failures. According to one analyst, “a number of these carriers
4 will go through bankruptcy more than once, and the cleansing effect on the market cannot be
5 experienced fully until more players actually consolidate or go out of business.””
6

7 56. Verizon suggests that many of the companies that have filed for bankruptcy are
8 operating normally and that Chapter 11 has been little more than a speed bump on the road to
9 success.⁹⁹ To support this claim, Verizon cites to press releases in which the companies state
10 that they will continue to operate without interruption during their reorganizations. But com-
11 pany press releases, which are designed to comfort worried investors and customers, are hardly
12 solid evidence that these companies will rebound from bankruptcy as reliable suppliers. And as I
13 have pointed out above, bankruptcy is not just a normal business condition; it is a serious
14 impediment to competition. Because dark fiber connectivity contracts are generally for lengthy
15 periods of time (in the range of 20-years), the buying carrier must have confidence that the
16 supplying carrier will be sufficiently stable to engage in long-term relationships. Companies that
17 have recently emerged from bankruptcy or that have experienced financial difficulty are unlikely
18 to instill that kind of confidence. As one industry analyst points out, “restructuring under
19 Chapter 11 protection may provide a new lease on life for a few firms, but it is not a magic bullet

96. *Id.*

97. *See Wholesale Voice Services 6339-63, Frost & Sullivan 2002, at 2.*

98. *See On the Ropes, at 4.*

99. *See Verizon Report, at 16.*

the "predictive judgment" that collocation serves as a proxy for relevant competition. And as I have previously noted and as AT&T has shown,⁷⁸ collocation is in any event a nearly irrelevant proxy for assessing the availability of facilities-based competitive alternatives to end users.

The Majority of Fiber Route Miles Operated by CLECs Are Long-Haul, Not Local.

50. Verizon claims that CLECs operate 184,000 route miles of fiber and that a majority of these miles are local, not long-haul.⁷⁹ Verizon does not provide numbers to back up its claim about the breakdown of these miles, nor does it explain how this conclusion was reached, other than to say that it is based upon public disclosures by the CLECs.⁸⁰ However, as Verizon itself acknowledges,⁸¹ most CLECs do not publicly report how many of the route miles they operate are purely local (as opposed to long-haul), so its assertion that a majority of these miles are local is highly speculative. Moreover, numbers provided by the few CLECs that do publish the breakdown between local and long-haul miles undermine Verizon's claim. For instance, McLeodUSA, Inc., which operates a large CLEC network, reports that only 5,000 of its 31,000 route miles of fiber are local, while the rest are long-haul.⁸² XO Communications, a large CLEC, states that its intercity long-haul network consists of 16,000 route miles of fiber, while its metro

78. See *Implementation of the Local Competition Provisions in the Local Telecommunications Act of 1996*, CC Docket No. 96-98, Declaration of C. Michael Pfau on Behalf of AT&T Corp. at 18-21, Filed July 17, 2002 ("Pfau Decl.").

79. See Verizon Report, at 1, 12.

80. *Id.* at 12, n. 53. Verizon derives its total figure of 184,000 route miles from the 2002 CLEC Report by New Paradigm Resources Group, Inc.

81. See Verizon Report, at 12.

82. See McLeodUSA Inc., Form 10K, on file with the Securities and Exchange Commission at 24.

1 upon the evidence provided above, it is clear that the majority of route miles operated by CLECs
2 are not local for purposes of provision of special access.

3
4 Wholesale Fiber Providers and Utility Competitors **Are Not a Reliable Source of**
5 **Supply.**
6

7 52. Verizon also makes exaggerated claims about the availability of wholesale local fiber,
8 stating that wholesale suppliers satisfy a large part of the CLEC's demand for interoffice trans-
9 port.⁸⁷ As with its assertions about route miles, Verizon offers no evidence to support this claim,
10 other than the self-promoting comments by some of the wholesale fiber providers themselves.
11 But as AT&T has pointed out in other proceedings,⁸⁸ there are several reasons to doubt that
12 wholesale fiber is a reliable source of supply for CLECs.

13
14 53. First, several analysts have questioned whether the wholesale dark fiber market is even
15 a viable market.⁸⁹ Indeed, witnesses for the ILECs themselves have raised this concern, pointing
16 out the difficulties involved in connecting to a fiber network that has already been built." As
17 one witness for Verizon has stated, "One doesn't plan and build fiber with the idea of going back
18 and reopening splices and touching them. To the contrary, one builds with the intent that you
19 won't ever have to go back."⁹⁰ Given these and other statements by the ILEC's own witnesses, it

X7. See Verizon Report, at 15

88. See *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-339, No. 96-98 & No. 98-147, Declaration of C. Michael Pfau on Behalf of AT&T Corp. at paras. 35-47, ("Pfau Declaration").

89. *Id.*, at para. 37 & n.18 (quoting U.S. Wholesale Wavelength Services 6337-64, Frost & Sullivan 2001, p.7).

90. *Id.*, at para. 39.

91. *Id.*

1 cated therein. On the one hand, there is a greater likelihood that a randomly arriving customer
2 will want service at a building at which CLEC facilities are in place than at a random building
3 among all of those served by the wire center: in that event, the 1.23% result would tend to under-
4 state actual conditions. On the other hand, it is also likely that the number of buildings being
5 served by AT&T nationwide — 6,700 — is far larger than for most other CLECs, so if the actual
6 distribution of CLEC on-net buildings were substituted for an "average" based solely upon the
7 AT&T figure that I have used here, the result would be significantly overstated. I do not present
8 this "corrected" version of the EMG "analysis" for the purpose of providing any specific "likeli-
9 hood" estimate, but rather for the purpose of demonstrating the fatal flaws in EMG's methodo-
10 logy and the sheer absurdity of its results. I believe that it is most likely that the probability of
11 some CLEC-provided alternative to ILEC special access being available for any given customer
12 in any given building is somewhere in the range of the results presented on Tables 9 and 10
13 above, i.e., somewhere between 1.23% and 15.79%, but probably a lot closer to the lower than to
14 the upper end of this range.

15
16 29. Additionally, as Professors Ordoover and Willig correctly observe, the presence of
17 CLEC-owned channel termination facilities is greatest where extremely high-capacity demand,
18 at the OCn level, is present, and virtually nonexistent where all that is required at a particular
19 customer site is capacity at the single DS-3 level or below." The EMG "study" implicitly
20 assumes a uniform distribution of CLEC-served buildings across all capacity levels. Conse-
21 quently, since the vast majority of individual special access type connections are at or below the
22 US-3 level — and a substantial majority at or below the DS-I level" — there is no basis to infer

24. Ordoover/Willig Reply Decl., at paras. 28-30

25. For example, Ameritech's most recent annual access filing with the Commission (using
2001 actual demand data, at the special access rates effective July 2002, projects \$601.9-million
total access revenue, with \$363.4-million categorized as DS-1, more than 60% of total revenues,
plus another 101-million for DDS and other digital lines, which brings the cumulative percentage
(continued...)

1 77. Moreover, assuming (as Kahn and Taylor do) for sake of argument that the analysis of
2 an average "revenue" per line based upon DS-0 equivalents has any validity, then one should be
3 able to examine the average "investment" and average "expense" per line as well. As Table 14
4 below reveals, during the 1996 to 2001 period in which average revenue per line declined by
5 only two tenths of percent, average investment and average expense per line each declined by
6 almost half. Review of those "average" per line results for those three categories more than
7 proves AT&T's initial point. During the 1996 to 2001 period, while the average revenue per line
8 dropped only \$0.33 from \$157.00 to \$156.67, the average expense per line dropped by \$59.78,
9 from \$123.33 to \$63.55, and the average investment per line dropped by \$103.45, from \$257.50
10 to \$154.05. Overall, the results demonstrate that by 2001, the net return, per DS-0 equivalent
11 access line had climbed by more than 185%, from the \$20.79 of 1996, to \$57.76.

Table 14							
Interstate Special Access Costs and Revenues RBOC Totals (Including GTE)							
	1996	1997	1998	1999	2000	2001	Change 1996-2001
(a) Revenues(000)	\$3,464,545	\$4,312,543	\$5,536,133	\$7,141,094	\$9,591,843	\$12,450,913	259.4%
(b) Expenses(000)	\$2,721,599	\$3,275,870	\$3,404,629	\$3,988,276	\$4,780,293	\$5,050,329	85.6%
(c) Net investment(000)	\$5,682,447	\$6,373,074	\$7,149,582	\$8,440,569	\$10,462,621	\$12,242,494	115.4%
(d) Net return	\$445,552	\$617,253	\$1,279,675	\$1,906,740	\$2,967,064	\$4,590,506	930.3%
(e) Rate of Return(d/c)	7.8%	9.7%	17.9%	22.6%	20.4%	37.5%	378.2%
(f) Special Access Lines	22,067,774	26,260,133	33,999,156	48,708,169	65,451,767	79,470,270	260.1%
(g) Revenues per line (a/f)	\$157.00	\$164.22	\$162.83	\$146.61	\$146.55	\$156.67	-0.2%
(h) Expenses per line (b/f)	\$123.33	\$124.75	\$100.14	\$81.88	\$73.04	\$63.55	-48.5%
(i) Investment per line (c/f)	\$257.50	\$242.69	\$210.29	\$173.29	\$159.85	\$154.05	-40.2%
(j) Net return per line (d/f)	\$20.19	\$23.51	\$37.64	\$39.15	\$45.33	\$57.76	186.1%
Sources of data:							
Financial data from ARMIS 4901, Column S, Rows 1090, 1190, 1910, 1915, and 1920.							
Lines are counted in terms of voice-grade equivalents, from ARMIS 4908, row 910, columns K and L.							

125. (. .continued)
authority at the end of 2000. BellSouth Petition for Pricing Flexibility for Special Access and
Dedicated Transport Services, CCB/CPD No. 00-20, Memorandum Opinion and Order, 15 FCC
Rcd 24588, (Dec. 15, 2000).

1 Verizon's Report Generally Fails to Distinguish Between the Hype of the Hi-Tech
Bubble Era and Current, Actual Special Access Competitive Conditions.

4 31. Verizon's claims of special access competition are outdated. They are based on a time
5 when massive CLEC growth was presumed, where plans were as good as implemented, and
6 where press releases and analyst statements were presumed accurate and reliable. Of course, this
7 era ended some time ago, and nowhere was this felt more acutely than the CLEC sector under
8 consideration. Verizon's attempts to belatedly tap into the hype of 2000 provide no basis for
9 judging competitive conditions in today's market.

10

11 32. The financial health of CLECs is nowhere near what it was a couple of years ago. Most
12 large special access providers face the bankruptcy and its crippling effect on investor confidence
13 and the CLECs' credit. For all but a few competitors, capital markets will hardly support
14 current operations, much less expansive "plans" relied on by Verizon.

15

16 33. The bubble-era hype infuses the Verizon report. For crucial evidence regarding the
17 availability of local fiber. Verizon relies upon announcements of "planned" or "intended" net-
18 work rollout announced in 2000 and 2001.²⁹ It cites Jack Grubman, to establish the robustness of
19 the now-crippled "wholesale fiber" sector." It credits as meaningful the announcement of a
20 "40.8 million round of equity financing" as proof that the capital markets have not all but closed
21 for many CLECs in this sector." Verizon points to a "web-based trading pit for metropolitan
22 fiber" as support for its assertions regarding the robustness and scope of fiber wholesalers — but

29. *Id.* at 17, Table 6 (citing AFS "plans to install" additional fiber, Fiber Technologies "planned network infrastructure"); *id.* at 20, Table 7 (stating that El Paso Global Network "plans to spend \$2 billion over the next four years on a nationwide fiberoptic network and 'plans to overbuild its metropolitan areas to provide better connectivity'").

30. *Id.* at 15, fn.70.

31. See Verizon Report at 16, Table 6 (citing a \$40.8 million round of equity financing for Yipes Communications).

1 special access were substituted for the embedded costs from ARMIS, the resulting rates of return
2 on forward-looking investment levels would be even higher.

3
3 74. In fact, while the **RBOCs'** service examples fail to show that **ARMIS** underallocates
5 costs to special access services (or overstates the appropriate revenues), historical experience and
6 costing trends actually support precisely the opposite conclusion. The **RBOCs** have a poor track
7 record for maintaining accurate records of their network investments, particularly as to the
X removal of plant no longer in service. The Commission's 1999 audit reports of **RBOCs'**
9 continuing property records found that these carriers could not account for approximately \$5-
10 billion in central office equipment that remained on their books.¹²⁴ If similar record-keeping
11 practices exist with respect to special access investments, it is likely that the **RBOCs'** regulatory
12 books of account also include costs for facilities that are no longer in service. The continuing
13 property records audits also demonstrated that the nature of the record-keeping errors was
14 consistently biased toward *including* items that should have been excluded, rather than the other
15 way around. Accordingly, it is far more likely that the embedded investment costs recorded in
16 **ARMIS** represent an *overstatement* of actual plant in service, thereby further contributing to the
17 highly conservative character of the Friedlander **ROR** figures.

18
19 75. The consistent upward trend in the **RBOCs'** rates of return for special access also tends
20 to belie their objections regarding the reliability of the **ARMIS** data. Even if there are allocation
21 errors in **ARMIS**, the **RBOCs** have offered no evidence to suggest that whatever misallocations
22 might actually be present, if any, are anything other than consistent from year to year. The
23 presence of any systematic bias in the data may impact the accuracy of individual data points,

124. 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers: Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, et. al., GTE Telephone Operating Companies Release of Information Obtained During Joint Audit, CC Dockets 98-137 and 99-117, AAD File No. 98-26, released April 3, 2000. FCC 00-119, at para. 15.

1	Knology Broadband	09/18/02
2	Birch Telecom	07/30/02
3	WorldCom	07/12/02
4	ITC^DeltaCom	06/25/02
5	XO Communications	06/16/02
	Advanced TelCom Group	05/02/02
	Mpower Communications Corp	04/08/02
8	Adelphia Business Solutions	03/27/02
9	Yipes Communications	03/21/02
10	Western Integrated Networks	03/13/02
11	Logix Communications	02/28/02
12	Network Plus Corp	02/04/02
13	McLeod USA	01/31/02
14	Global Crossing Ltd.	01/28/02
15		

16 36. Of the sixteen major providers of special access services identified by Verizon,³⁶ six are
 17 in bankruptcy, while a seventh is **just** now emerging from bankruptcy protection. Six of these
 18 bankrupt providers fall within the top 9, in terms of their special access revenues. The table
 19 below reproduces Verizon's presentation of major special access competitors to the ILECs, with
 20 shading indicating **those** that have declared bankruptcy.³⁷
 21

36. See Vericon Report, at 9, Table 4.

37. See CLEC Report 17th ed., at Ch. 2, pp. 2-4

1 those special access investments. And, of course, if DSL costs *are* being included in the ARMIS
2 data for special access, then it is certainly appropriate to also include corresponding DSL
3 revenues, as had been done in the Friedlander declaration filed with AT&T's Petition.¹¹⁹
4 Accordingly, the figures provided by AT&T for special access rates of return — which in some
5 cases exceeded 50% — have in no sense been impeached by the RBOC experts.

6
7 70. *Mismatch between allocation of expenses and revenues for marketing.* Verizon claims
8 that "marketing expenses are allocated across all access categories, but that the associated
9 revenues are recovered from common line and special access."¹²⁰ This claim is unfounded. Prior
10 to price cap regulation, marketing expenses were allocated to and recovered from all interstate
11 services in proportion to the investments assigned by the Part 69 cost allocation rules. The
12 Commission's May 1997 *Access Reform Order* retained the assignment of marketing costs to
13 special access and interexchange services that are marketed to retail customers, but removed
14 marketing from switched access elements (by reducing the price cap indices for the common
15 line, traffic sensitive, and trunking baskets) sold exclusively on a wholesale basis.¹²¹ Neither this
16 change, nor any subsequent Commission action, has diminished the level of marketing expenses
17 recovered from special access rates.¹²²

18
19. Declaration of Stephen Friedlander on Behalf of AT&T Corp., RM 10593, October 15,
2002.
20. Verizon Comments, at 22.
21. *Access Charge Reform*, First Report and Order, FCC 97-158, released May 16, 1997,
para. 323.

22. As another example of a category-specific ARMIS cost-revenue mismatch, Verizon
mentions that "amounts collected for universal service recovery are booked as common line
revenues, while amounts due to USAC [Universal Service Administrative Corporation] are
recorded in the interexchange category." Verizon Comments at 22, fn. 50. However, neither
the costs nor the revenues in question have any impact upon special access and, thus, Verizon's
example is completely irrelevant to the matter at hand.

CLEC assertions regarding a-net buildings have often proved overstated, with unexpected and undisclosed reliance upon resale of CLEC special access services.⁴⁰

Verizon Overestimates CLEC Revenues and Market Share.

38. Verizon attempts to portray the CLECs as vigorous competitors in special access markets based upon claims that CLEC revenues represent approximately \$10-billion out of a \$28-billion market, with consistent growth, and that particular CLECs have robust special access revenues.⁴¹ Even if true, these claims would not support the assertion that relevant markets are competitive. Indeed, they would be entirely consistent with the highly segmented competitive markets that AT&T has documented.⁴² Multiple providers of special access services may deploy facilities in a few areas where customers are highly concentrated (indeed, have dramatically overbuilt in those areas), but competitive alternatives do not extend to most buildings or to most users even within relatively competitive **MSAs**, and the expansion of facilities-based competition appears to have stalled because the overwhelming majority of buildings cannot be served economically by a CLEC. In sum, certain high-volume customers may have competitive alternatives in a limited number of locations, but most do not even in areas subject to Phase II relief.⁴³

39. In fact, Verizon's portrayal of CLEC revenues, growth, and market share — even using the sources Verizon relies upon — is inaccurate, lacks analytical integrity and conceals a deeply troubled service sector that has largely stalled. First, while Verizon repeatedly suggests that the

40. Thomas Decl., at para. 8.

41. See **Verizon** Report, at 2, 27, and Table 4.

42. See AT&T Reply Comments, at 10-19.

43. See, e.g., *Comments of the Ad Hoc Telecommunications Users Committee*, at 3-4.

Table 13

Estimated Interstate Special Access Costs and Revenues
By RBOC (Including GTE)
\$ in Thousands

	BellSouth		Qwest		SBC		Verizon		Sum RBOC	
	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001
Revenues	1,233,259	1,853,719	\$1,226,147	\$1,547,442	\$3,405,544	\$4,374,967	\$3,718,755	\$4,656,039	\$9,583,705	\$12,432,167
Expenses	494,806	651,550	\$517,281	\$540,240	\$1,374,033	\$1,286,951	\$2,387,030	\$2,564,752	\$4,773,150	\$5,043,493
Net Return	458,996	751,379	\$452,893	\$646,769	\$1,261,469	\$1,928,324	\$793,275	\$1,252,839	\$2,966,633	\$4,579,311
Net investment	1,247,668	1,525,302	\$1,181,070	\$1,407,245	\$2,919,756	\$3,531,727	\$5,102,557	\$5,768,191	\$10,451,051	\$12,232,465
Rate of Return (%)	36.79%	49.26%	38.35%	45.96%	43.20%	54.60%	15.55%	21.72%	28.39%	37.44%
Revenue Attributable to DSL	\$51,600	\$183,456	\$88,193	\$159,197	\$0	\$0	\$143,280	\$377,622	\$283,073	\$720,275
Rate of Return without DSL	32.65%	37.23%	30.88%	34.65%	43.20%	54.60%	12.74%	15.17%	25.68%	31.55%

Source: ARMIS Table 43-01, Accounts 1090, 1190, 1910, 1915. DSL Revenue figures are based on the average of prior and current year-end DSL subscriber figures (where 1999 subscriber figures were not released, the number was assumed to be 0) multiplied by the average annual revenue from broadband access, as estimated by McKinsey & Company/JP Morgan in *Industry Analysis: Broadband 2001*, April 2, 2001, at Table 2. As noted by Kahn/Taylor, SBC DSL revenues are not included in special access ARMIS data, and therefore have not been removed.

1 and growth assumptions and adjusting for these three factors, the 2001 CLEC share of the local
2 access and private line market is 22%.⁵¹

3
4 41. Third, the component revenues that Verizon relies on to come up with the supposed
5 \$10-billion special access revenue total for CLEC services are plainly exaggerated. Verizon's
6 Table 4 purports to capture the special access revenues of CLECs that provide more than \$20-
7 million of services, but the basis for this calculation fails to withstand scrutiny. The flaws in this
8 table include:

9
10 Even if taken at face value, the figures as presented by Verizon sum to less than \$7.24-
11 billion in CLEC special access revenues.

12
13 AT&T's 2001 special access revenue is presented as \$2.88-billion, but New Paradigm
14 now estimates that figure to be \$2.38 billion.⁵²

15
50. (...continued)
18.

51. ILEC 2000 revenues for local private line and special access services, derived from the same FCC tables that Verizon uses, are \$13.5 billion. FCC, Industry Analysis Div., *Telecommunications Industry Revenue* 2000, at 13 & 17. For 2001, using Verizon's ILEC revenue growth assumption (Verizon Competition Statement, at 27), indicates ILEC 2001 special access revenues of \$18.6 billion. FCC tables indicate \$3.22 billion of CLEC local private line and special access revenue in 2000, FCC Industry Analysis Div., *Telecommunications Revenue* 2000, at 14 & 18, which, using the New Paradigm Resources Group estimate of the growth rate in CLEC special access revenues from 2000 to 2001 (17.9%), increases those revenues to \$3.8 billion for 2001. Adding Verizon's aggressive estimate of \$1.3 billion of "self-supply" by AT&T and MCI brings the 2001 CLEC total to \$5.1 billion. $5.1/(5.1 + 18.6) = .22$.

52. *Id.*, AT&T carrier profile at 1, 6 (estimating that dedicated access transport – the source Verizon employs for its special access revenue calculations – accounted for 18% of total revenues, which were \$13.2 billion).

Table 12					
Estimated Interstate Special Access Costs and Revenues By RBOC (Including GTE) Using Kahn/Taylor DSL Revenue Assumptions \$ in Thousands					
	BellSouth	Qwest	SBC	Verizon	Sum RBOC
	2001	2001	2001	2001	2001
Revenues	1,853,719	\$1,547,442	\$4,374,967	\$4,656,039	\$12,432,167
Expenses	651,550	\$540,240	\$1,286,951	\$2,564,752	\$5,043,493
Net Return	751,379	\$646,769	\$1,928,324	\$1,252,839	\$4,579,311
Net investment	1,525,302	\$1,407,245	\$3,531,727	\$5,768,191	\$12,232,465
Rate of Return (%)	49.26%	45.96%	54.60%	21.72%	37.44%
Revenue Attributable to DSL	\$264,000	\$39,689	\$0	\$106,311	\$410,000
Rate of Return without DSL	31.95%	43.14%	54.60%	19.88%	34.08%
Source: ARMIS Table 43-01, Accounts 1090, 1190, 1910, 1915. Revenue figures are based on Kahn/Taylor assertion that total DSL revenues in 2001 for BellSouth, Verizon and Qwest were \$410 million (Kahn/Taylor, at 15). BellSouth DSL revenue figures from the BellSouth 2001 Annual Report, Verizon and Qwest figures are estimates based on proportion of each company's DSL subscribers and residual revenues from the Kahn/Taylor revenue figure after removal of BellSouth revenues. As noted by Kahn/Taylor, SBC DSL revenues are not included in special access ARMIS data, and therefore have not been removed.					

67. Removing all DSL revenues for all **RBOCs** claiming to book those revenues to special access accounts reduces the special access rates of return by about 3.3%. Total RBOC return on special access services, per ARMIS, would decrease from 37.44% to 34.08% *if DSL revenues are removed* but without any other adjustments. This estimate, however, is likely to be highly conservative (i.e., to understate the residual special access rates of return) since, as explained below, it is also likely that at least some, perhaps even most, DSL investment and associated expenses are *also* included in special access accounts. Indeed, BellSouth has specifically noted that it assigns DSLAM circuit investment to special access, confirming the conservative nature

1 • McLeod USA is presented as having \$91-million in special access revenues. New
2 Paradigm estimates that the company's special access revenues for 2002 were \$77-
3 million.⁵⁷
4
5 • As noted above, the relevant market concerns local special access and private line,
6 which requires reduction of the resulting figures by, in aggregate, 23% (the portion of
7 CLEC special access revenues attributable to interstate private line services).
8
9 Making these adjustment, based upon Verizon's own source, reduces the overall CLEC special
10 access revenues to \$4.6-billion. or \$4.2 billion if Qwest is excluded altogether.⁵⁸ That's less than
11 half the \$10-billion figure being touted by Verizon.
12
13 42. Finally, and of particular importance for assessing the extent of facilities-based
14 competitive alternatives, much of the CLEC revenues reflect *resold* ILEC special access faci-
15 lities. Verizon confirms that BOCs provide approximately 56% of their special access lines (by
16 voice grade equivalent) to competing carriers,⁵⁹ and Verizon credits these lines as ones that are
17 included in the CLEC numbers of voice grade equivalent lines served. Verizon derives this
18 figure from the ratio of revenues the BOCs receive from end users as opposed to competing
19 carriers. While Verizon likely overestimates the percentage of its resold lines that are employed
20 as CLEC-served lines (rather than being used for upstream services), even if one assumes a
21 somewhat reduced percentage, the implications are clear: CLEC revenues for special access
22 services provided on a facilities basis ("on net") — which are the only relevant revenues for

57. *Id.*, McLeod carrier profile, at 6 (estimating that dedicated access transport accounted for 7 percent of total revenues, which were \$1.1 billion).

58. These figures were arrived at by substituting the updated revenue amounts in Verizon's Table 4 (CLEC Special Access Revenues) and then subtracting 23% of that total.

59. See Verizon Report, at 24

1 make its cost accounting rules, as reported under ARMIS, obsolete.'" The Commission has
2 appropriately resisted the RBOCs' persistent attempts to **make** ARMIS a tool of deregulation
3 rather than a regulatory tool that gets updated to reflect changes in regulatory requirements made
4 in response to such competition as has been shown to exist.¹¹²

5
6 65. Each of the RBOCs advances the *possibility* that the specific allocation of costs and
7 revenues to individual service categories, as reflected in ARMIS, *could* result in the understate-
8 ment of special access costs (or the overstatement of revenues), and hence in an overstatement of
9 rates of return on special access services. However, the RBOCs offer very few specific
10 examples to support this claim, and the several that they do provide cannot begin to account for
11 the very significant excess earnings levels that AT&T has calculated based upon the ARMIS
12 data.'" Where the RBOCs' claims have been articulated in sufficient detail to permit it, I have
13 examined these specific criticisms and have determined that they are either (a) erroneous, (b)
14 irrelevant to special access, (c) have an insignificant financial impact upon the special access

111. Comprehensive Review of Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase I, CC Docket 99-253, released March 8, 2000, at para. 48: "The Commission continues to require accounting and financial data about these carriers to make informed regulatory judgments on numerous policy and ratemaking issues. Furthermore, under the current regulatory price cap scheme, carriers have the ability to seek full recovery of regulated costs through low-end adjustments, as well as taking claims. Thus, our continued monitoring of the reasonableness of these costs is necessary." See also, 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and **ARMIS** Reporting Requirements for Incumbent Local Exchange Carriers, Phase 2, CC Docket 99-253, FCC 00-199, released November 1, 2001, at paras. 10-12.

112. See, e.g., 2000 Biennial Regulatory Review of Accounting and **ARMIS** Requirements, *supra*, at para. 6: "In adopting these rule changes, we have attempted to steer a course that avoids both deregulation simply for its own sake and the countervailing temptation to retain rules that may no longer be necessary."

113. As an aside, it should be noted that the RBOCs are hardly passive recipients of the Commission's cost allocation rules. Over the years, RBOC input has worked to shape cost accounting and other reporting requirements in ways that, if anything, work to support, and not frustrate, **RBOC** strategic goals.

1 44. In large measure, Verizon accepts this crucial analysis. It credits an estimate that non-
2 ILEC special access providers can provide on-net service to only approximately 30,000
3 commercial buildings nationwide,⁶² which represents less than 1% of the total buildings served
4 by ILECs.

5
6 45. At the same time, Verizon makes a series of marginal claims that attempt to blunt the
7 force of this basic concession. First, Verizon indicates that the number of on-net buildings is
8 "constantly increasing" and cites an AT&T statement that its local fiber network is growing.⁶³
9 While it is undoubtedly true that AT&T's connections are increasing, AT&T has also established
10 that facilities-based special access competition is inherently limited to a small subset of highly
11 concentrated, high-traffic customers.⁶⁴ More importantly, the number of on-net buildings of
12 other important providers of special access services is not increasing: as service providers exit
13 the business altogether or scale down operations as part of Chapter 11 proceedings, reduce their
14 effective connections, or reveal that their "on net" building and network claims were in fact
15 examples of irrationally exuberant overstatement.⁶⁵

16
17 46. Verizon also claims that CLECs serve "approximately 330,000 buildings," while
18 admitting that more than 90% of these buildings are served in part or whole through resale of
19 ILEC special access facilities." Even the larger figure provides no sound indication of
20 competition even to that subset of buildings. Verizon relies upon a New Paradigm Resources
21 Group report for its figure, but that report indicates that the two providers with the greatest

62. See Verizon Report, at 13.

63. *Id.*

64. See AT&T Reply Comments, at 11.

65. See discussion of Winstar, *supra* at para. 37.

66. See Verizon Report, at 13.

1 estimates that RBOCs collect "less than 15 percent of nationwide ATM and Frame Relay
2 revenues" and then attributes this fact as "due to the restrictions on provision of interLATA
3 services."¹⁰⁶ Verizon does not even attempt to minimize the RBOC share of local services for
4 large business customers: other than to note that CLECs serve a small minority of switched
5 access lines using their own facilities or resold ILEC lines. Blinking at reality, Verizon seeks to
6 establish the vibrancy of competition by quoting a CLEC industry group's assessment of its own
7 members as "solid, well-financed companies [ready] to compete head-to-head with Bell
8 companies."¹⁰⁷

9
10 61. Verizon's market share evidence is entirely consistent with the structure of markets
11 vulnerable to and affected by a monopolist's anticompetitive actions, and in fact evidence of
12 those abuses in the special access market is widespread. AT&T has provided the Commission
13 with pervasive evidence of non-price discrimination, particularly in the provisioning of special
14 access service to competitors, and the NYPSC has documented widespread non-price practices
15 with anti-competitive implications for markets that require RBOC special access services as an
16 input.¹⁰⁸ Similarly, AT&T has documented that the RBOCs engage in classic price squeeze
17 tactics: in more than half the areas examined in a wide-ranging study, the RBOCs charged
18 AT&T far more for special access than charges to its retail customers for intraLATA frame relay
19 or ATM ports — in some areas, 150% more than a rate that would have allowed AT&T to
20 provide a competitive offering.'"

106. *Id.*, at 30

107. *Id.*, at 31-32 (quoting statement of ALTS, from Communications Daily, CLEC Industry Will Revive in 2003. Report Says (Oct. 18, 2002).

108. See *Comments of AT&T, Review of Regulatory Requirements for Incumbent LEC Broad-band Telecommunications Services*, CC Docket 01-337, at 32-37 (March 1, 2002) (presenting evidence and surveying NYPSC reports).

109. *Id.*, at 33 (citing Benway Declaration)

1 4X. 'The NYPSC's careful examinations of competitive facilities in the most highly concen-
2 trated market, New York City, shows the irrelevance of Verizon's emphasis upon concentration
3 for showing that an overall **MSA** market is competitive. In concluding that Verizon remained
4 dominant in the provision of special access Services for all geographical areas in the state
5 including Manhattan, the NYPSC concluded that Verizon's own data revealed that "a maximum
6 of 900 buildings [are] served by individual competitors' fiber." " In contrast, New York City has
7 more than 220,000 buildings that are "mixed use, commercial, industrial or public institutions." "
X Because CLEC fiber loops were irrelevant to actual provision of services unless joined by further
4 facilities to particular buildings, the NYPSC report concluded that "Verizon represents a bottle-
10 neck to the development of a healthy market for Special Services" (equivalent to special access
11 services).⁷⁵

12
13 49. Finally, Verizon argues at length that evidence of collocation demonstrates the
14 existence of special access competition and cites the Commission's reasoning that collocation is
15 an accurate basis to predict the presence of competition throughout most of an **MSA**.⁷⁶ With all
16 due respect, that issue is the one now challenged before the Commission by evidence that, not-
17 withstanding collocation, competitive alternatives are not available in broad areas of the **MSAs**
18 subject to Phase II relief.⁷⁷ Faced with that evidence, the Commission will need to address the
19 scope of actual competitive alternatives, and neither the Commission nor Verizon can rely upon

73. *See Proceeding on Motion of the Commission to Investigate Methods to Improve and Maintain High Quality Special Services Performance by Verizon New York, Inc., Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting*, NY PSC Case 00-C-2051, at 7-8 (June 15, 2001) ("NYPSC June Special Services Order").

73. *Id.*

75. *Id.*, at 9.

76. *See Verizon Report*, at 14.

77. *See Tables 6 and 7 supra*

1 for all that ails the carriers' carrier industry. In fact, it may actually prolong industry turmoil and
2 uncertainty."""

3
4 57. Verizon's final claim is that the entry of utility companies into the wholesale supply
5 business will provide CLECs with the fiber they need for special access." But this assertion is
6 as unsupported as all the others that Verizon has made. Although some utility companies have
7 expressed an intention to supply fiber, there is no evidence that any of the utility companies
8 listed by Verizon will soon become significant players in the wholesale market. Indeed, of the
9 sixteen companies listed by Verizon, seven give no indication on their websites that they even
10 offer carrier services; one has ceased its telecommunications operations; one is bankrupt; and
11 one does not own its own metro fiber.¹⁰² Of the remaining companies, one expresses a lack of
12 interest in providing dark fiber. Utility companies may eventually have some success in pro-
13 viding limited metro fiber services because of their low incremental cost of deploying fiber in
14 existing rights-of-way, using existing structures and construction resources." But utilities have
15 no obligation to provide supply to CLECs, nor do they have any incentive to price their services
16 below those of ILEC alternatives, such as special access. It is therefore premature to conclude
17 that utilities will become a viable source of supply for CLECs.

18
19 **The Evidence Shows that ILECs Have Undermined Downstream Service Competition.**
20

21 58. Verizon devotes considerable effort to demonstrating that the ILECs have not yet under-
22 mined competition in markets that employ special access services as an input, and claims that

100. See The Carriers' Carrier Playbook, at 17.

101. See Verizon Repon, at 18.

102. See, e.g., Pfau Declaration, at para. 46.

103. *Id.*, at para. 47.

1 fiber network spans only 4,300 miles.⁸³ And Adelphia Business Solutions reports that it has
2 9,536 local route miles and **7,879** long-haul miles.⁸⁴ Thus, ~~of~~ the nearly **70,000** route miles
3 operated **by** the ~~three of~~ the largest CLEC networks, only 19,000 — or 27 percent — are local.
4 This hardly qualifies as a majority.

5
6 **51.** In addition, many CLECs included in the list from which Verizon arrived at its total of
7 184,000 route miles do not even provide special access services. For example, the New
8 Paradigm report lists Knology Broadband as having **5,568** route miles ~~of~~ fiber, and Verizon
9 apparently counts these **miles** in reaching its total of **184,000**. **But** according to New Paradigm,
10 Knology does not generate any revenue from special access services." In fact, eight of the
11 CLECs included in the list from which Verizon arrived at its total figure do not generate any
12 revenue from special access services." In addition, several other **CLECs**, such as **CTC**
13 Communications Corp., generate only one or two percent ~~of~~ their revenues from special access
14 services — again, indicating that most of the route miles operated by these companies are not
15 relevant **to** an analysis of competitive fiber special access services. Verizon does not take into
16 account any of these considerations in asserting that a majority ~~of~~ the **184,000** route miles
17 operated by CLECs are local. It simply makes this assertion and then treats it as fact. But based

83. *See XO Launches Broadband Services in San Antonio*, Jan. 10, 2001, press release available at <http://www.xc.com/news/54.htm>; *XO Will Provide Nationwide Gigabit Ethernet Service*, Sept. 25, 2000, press release available at <http://www.xo.com/news/26.html>.

84. *See Adelphia Business Solutions, Inc. Announces Third Quarter Results & Operations*, Nov. 12, 2001, press release available at http://www.prnewswire.com/cgi-bin/micro_stories.pl?ACCT=119453&TICK=ABIZQ&STORY=/www/story/11-12-2001/0001614064&EDATE=Nov+12,+2001.

85. *See* CLEC Report 2002, Ch. 6 (15th ed.)

86. In addition to Knology, **the** following companies do not generate any revenue from special access services: RCN Corp.; Allegiance Telecom, Inc.; Advanced TelCom Group, Inc.; Choice One Communications; Global Crossing, Ltd.; Florida Digital Network; SunWest Communications. *See* CLEC Report 2002, Ch. 6 (15th ed.). Together, these companies operate 22,509 route miles of fiber. *Id.*, Ch. 4 at Table 13.

1 is more than a little surprising that Verizon now suggest that access to dark fiber will be easy or
2 quickly attainable.

3
4 53. The second major obstacle to the use of wholesale fiber is the precarious financial
5 situation the industry now finds itself in. Verizon's presentation of the facts is once again
6 trapped in a time warp, touting the promise of the wholesale fiber industry as if the bubble era
7 still existed. But the bubble has burst, and the "wholesale data market has been one of the seg-
8 ments most severely affected by the telecommunication's industry's turmoil."⁹² "After several
9 years of initially promising growth, the carriers' carrier industry is now under the gun. Some
10 firms have already ceased operating, others are in Chapter 11 looking to recover, and many
11 others are struggling."⁹³ Indeed, of the nine companies cited by Verizon as wholesale local fiber
12 suppliers, three have filed for Chapter 11 bankruptcy, and several others have experienced finan-
13 cial difficulty."⁹⁴ Others, such as American Fiber Systems and Fibertech Networks, have
14 announced plans to develop significant networks, but have so far only deployed dark fiber in a
15 handful of smaller markets.

16
17 55. Forecasts for the future are equally dim. "The shakeout gripping the U.S. carrier
18 industry is not over," a recent industry analysis declared.⁹⁵ "Simply put, there are still too many
19 players with too much debt and little competitive differentiation chasing too few customers, who

92. See *North American Wholesale Data Market on the Ropes* at 2, Gartner Dataquest, November 13, 2002 ("On the Ropes").

93. *The Carriers' Carrier Playbook* at 3, The Yankee Group, August 2002.

94. The suppliers that have declared bankruptcy are Metromedia Fiber Networks, Northeast Optic Network, and Yipes Communications. In addition, both Progress Telecom and NEESCom reported losses in recent public disclosures. See Pfau Declaration at 24. Many of the other companies cited by Verizon are privately held, and therefore financial information is not readily available.

95. *Id.*, at 17.